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C O N F I D E N T I A L LA PAZ 002661

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TAGS: [ECON](#) [EINV](#) [ENRG](#) [EPET](#) [BL](#)
SUBJECT: GAS CONTRACT NEGOTIATIONS STUMBLE FORWARD

REF: A. LA PAZ 1157

- [1](#)B. LA PAZ 2519
- [1](#)C. LA PAZ 1805
- [1](#)D. LA PAZ 1936
- [1](#)E. LA PAZ 1842
- [1](#)F. LA PAZ 1491

Classified By: Amb. Philip Goldberg for reasons 1.4 (b) and (d).

[1](#)1. (C) Summary: Based on the May 1 hydrocarbons nationalization decree's mandate that private firms must sign new contracts by October 31 (ref A), the GOB recently provided hydrocarbons companies with draft contracts and began the first round of negotiations with companies on September 27. U.S.-owned Vintage Petroleum said that the draft contract was unacceptable, as it referred to resolutions and laws that do not yet exist. According to Vintage, the GOB would like the companies to sign contracts by the end of October and work out important issues later. On a positive note, companies view recently named Hydrocarbons Minister Villegas as more flexible than his predecessor (ref B). Vintage expressed concern that the GOB might follow through on its threat to expel companies that do not sign by the deadline, but draft legislation currently under consideration by Congress may extend the time limit. The Bolivian Hydrocarbons Chamber told the DCM that the five companies destined for GOB take-over by the nationalization decree were unlikely to agree to cede operating control. Pipeline operator Transredes confirmed this assertion. According to the Chamber President, gas price negotiations between Bolivia and Argentina were proceeding fairly smoothly, but volume negotiations were problematic (ref C). Transredes warned of potential blackouts after 2007 due to the freezing of an important pipeline construction project (ref D). End summary.

U.S. Gas Company Says Draft Contract Unacceptable

[1](#)2. (C) The GOB's May 1 hydrocarbons nationalization decree required that private investors sign new contracts, to be approved by the Bolivian Congress, by October 31, 2006 (ref

A). Vintage Petroleum Manager Jorge Martignoni and parent company Occidental Petroleum Latin American Legal Adviser Greg Romero told Econoff on September 28 that the GOB provided an incomplete, draft contract to the company. (Note: Although U.S.-owned Occidental Petroleum acquired Vintage, it has decided to continue operating as Vintage in Bolivia, a legally separate entity, to avoid potential damage to Occidental. End note.) Company representatives held their first meeting to discuss the draft contract with Hydrocarbons Minister Carlos Villegas, state oil company YPFB President Juan Carlos Ortiz, and other YPFB representatives on September 28. Martignoni said that the GOB insisted that Vintage must sign a new contract by the end of October, the deadline imposed by the May 1 nationalization decree. Vice President Alvaro Garcia Linera stated to the press on September 19 that the companies must stick to the October 31 deadline or leave. However, the draft contract refers to regulations that have not yet been issued and nonexistent laws, Martignoni said.

Sign Now, Settle Later Untenable

13. (C) The GOB had planned to use the results of company audits as the basis for contract negotiations; however, the audits are not scheduled to be completed until the end of November. Martignoni said that the government has asked the auditors to provide an interim report by October 10 to serve as the basis for negotiations. In view of the time pressure, the GOB wants the hydrocarbons companies to sign new contracts first and work out important issues later -- a position which the companies cannot accept, explained Romero. The companies cannot sign contracts under such uncertain conditions, he added. British DCM Steve Townsend told us that British Gas (BG), who also met with the GOB on September 28, had received a similar, unacceptable draft contract from the GOB. He said that BG was willing to significantly expand its presence in Bolivia provided that there was legal stability, but unfortunately, that was not the case.

But New Minister Seems More Flexible

14. (C) Martignoni said that the recently named Minister Villegas seemed more flexible than the previous radical Minister Andres Soliz Rada (ref B). Villegas made an attempt to behave in a conciliatory manner in the meeting, but it was clear that the GOB would not negotiate certain issues, including the right of YPFB to commercialize hydrocarbons. However, Villegas, unlike Soliz Rada, apparently is willing to allow companies to book Bolivian gas reserves as assets, according to Martignoni.

Sign or Leave?

15. (C) Romero expressed concern that the GOB would follow through on its threat to kick out companies that did not sign new contracts by October 31. He explained that only about 5 percent of Vintage's staff were foreigners, with the bulk being locally-hired. He added that the Ecuadorians had been able to continue operating Occidental's business in Ecuador after ejecting the foreigners, although at a loss. However, press reports on September 29 indicated that the Chamber of Deputies' Economic Development Commission is considering a draft law that would raise the May 1 nationalization decree to the rank of law and extend the contract negotiation deadline by 30 to 60 days. The initiative reportedly has not been discussed with the Executive branch. (Comment: It seems unlikely that the GOB could manage fields currently being operated by multinationals due to the lack of expertise in country. The draft law under consideration in Congress also sheds doubt on the idea of expelling the companies. Some speculate that Venezuela's PDVSA might fill the void that would result from such action, but PDVSA lacks experience in natural gas operations. End comment.)

Hydrocarbons Chamber Outlines Negotiation Obstacles

16. (C) Bolivian Hydrocarbons Chamber Vice President Raul Kieffer told the DCM on September 22 that completing

contracts with all the companies by the end of October would not be feasible. He added that the five companies destined for GOB majority ownership by the May 1 decree, including two with U.S. investment -- Transredes and Chaco, were unlikely to agree to sell company shares to the government without assurances of maintaining operating control (ref A). He said that the sector was somewhat more optimistic about negotiations since the replacement of Minister Soliz Rada with Minister Villegas, but were still keeping all but essential investments on hold. He explained that the GOB resolution that confiscated Petrobras' refinery production and led to vehement Brazilian complaints and Minister Soliz Rada's ousting (ref B) was frozen, but still legally in force, adding to the uncertainty of an already uncertain situation. Price formula negotiations between Bolivia and Argentina, due to be completed by year-end, were proceeding fairly smoothly; however, volume negotiations were more complicated because Bolivia lacked the capacity to supply additional volumes to Argentina without additional investment which was on hold (ref C), according to Kieffer.

Transredes Unwilling to Cede Operating Control

17. (C) In a meeting with Econoff on September 23, Transredes executive Oscar Serrate seconded Kieffer's assertion that Transredes would not agree to cede operating control to YPFB. Although the company is willing to negotiate share sales, it is unwilling to risk damaging its reputation (and those of its investors Prisma and Shell) by allowing YPFB operating control, which could result in accidents. According to Serrate, the GOB has expressed flexibility on the operating control issue in recent meetings.

Transredes' Credit Freeze Could Produce Blackouts

18. (C) The GOB's attempts to change Transredes' shareholder structure have placed the company in a tight spot with its creditors -- the Inter-American Development Bank (IDB) and the Andean Development Corporation (CAF) -- who have frozen loans to the pipeline operator (ref D). Serrate recently traveled to Washington with GOB representatives to meet with the IDB and the CAF. Serrate said that the GOB representatives demonstrated their naivete in requesting that the IDB and CAF just sign over the loans to YPFB, which the lending institutions refused. Without the financing, Transredes will be unable to complete pipeline projects that would bring gas to the Cochabamba area, enabling increased electricity generation to meet increasing demand. He predicted that the country would face electricity shortages after 2007. Serrate also commented on the failings of Bolivian justice, noting that he is under investigation by the prosecutor's office and named as a defendant in a law suit against Enron (ref E), even though he was in New York working for the United Nations at the time in question. (Note: Enron is the former owner of Transredes investor Prisma, which was recently sold by Enron to Ashmore Energy, which is 40 percent U.S.-owned (ref F). End note.)

19. (C) Comment: With President Morales' approval ratings dropping to 52 percent on September 29, the MAS administration is likely feeling significant pressure to deliver something to the public framed as new hydrocarbons contracts on October 31. On the other hand, there is not enough time to complete serious negotiations with the companies and arrive at consensus prior to that date. Despite the Vice President's threats to sign or leave, in line with the May 1 nationalization decree, it seems that the GOB cannot afford to expel the international gas operators and will be forced to come up with a clever way to save face when it once again has to extend its self-imposed deadline. End comment.
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